

Avalon Technologies

Estimate change	↓
TP change	↓
Rating change	↔

CMP: INR507 **TP: INR610 (+20%)** **Buy**

Challenges within the US business drag overall performance

Earnings lower than our estimate

- Avalon Technologies (Avalon) reported a weak quarter with a revenue decline of 8%/3% YoY in 3QFY24/9MFY24, led by a continued slowdown in the US business (reported a loss of ~INR200m in 9MFY24). However, the India business registered a growth of 12% in 9MFY24.
- The order book showed some resilience with order inflows of ~INR2.45b across sectors (such as Power, Industrial, Clean energy, Automotive and Railways). The inflows led to an increase in the closing order book to INR12.75b as of Dec'23 (vs. ~INR12.4b/INR11b in Sep'23/Jun'23).
- Factoring in the weak 3QFY24 performance and a slowdown in the US business that led to an operating leverage, we reduce our EPS estimates for FY24/FY25/FY26 by 44%/25%/19%. **Reiterate BUY with a TP of INR610 (premised on 35x FY26E EPS).**

Operating leverage results in a margin contraction

- Consolidated revenue declined 8% YoY, while it grew 7% QoQ to INR2.1b (est. INR2.7b) in 3QFY24, due to challenges within the US business. EBITDA margin contracted 100bp YoY, while it rose 140bp QoQ to 7.7% (est. 9.6%), dragged by operating leverage. Adjusted PAT grew 15% YoY, while it declined 10% QoQ to INR66m (est. of INR144m).
- During 9MFY24, Avalon's revenue/EBITDA/Adj. PAT declined 3%/34%/30% YoY to INR6.5b/INR454m/INR209m.
- The Indian market's revenue rose 12% YoY in 9MFY24, but challenging conditions in the US market led to a decline in the US business revenue. As a result, overall revenue declined 8% YoY during the period.
- Net working capital days increased to 155 from 144 in Mar'23, primarily led by higher inventory days (up 18 days).

Highlights from the management commentary

- Guidance:** Management expects ~8-10% YoY decline in revenue for FY24, with an EBITDA margin of ~7-8%. Going forward, the company has guided for a revenue growth of ~20-25%.
- The US business** recorded a loss of INR200m in 9MFY24. However, the company is witnessing traction from some of its customers, and expects a recovery within the business in 1HFY25, which will be further accelerated in 2HFY25.
- India business:** Management expects a strong traction from the railways (Signaling system, Kavach, Vande Bharat), Industrial, Energy, and EVs in the domestic market. To cater to the growing domestic demand, the company is planning to expand its existing domestic facilities.

Bloomberg	AVALON IN
Equity Shares (m)	65
M.Cap.(INRb)/(USD\$b)	33.3 / 0.4
52-Week Range (INR)	732 / 347
1, 6, 12 Rel. Per (%)	-6/-24/-
12M Avg Val (INR M)	253

Financials & Valuations (INR b)

Y/E Mar	FY24E	FY25E	FY26E
Sales	8.8	11.3	14.7
EBITDA	0.7	1.2	1.7
Adj. PAT	0.3	0.7	1.1
EBITDA Margin (%)	7.7	11.0	11.8
Cons. Adj. EPS (INR)	4.8	11.4	17.4
EPS Gr. (%)	(46.7)	136.7	52.2
BV/Sh. (INR)	87.3	98.7	116.1

Ratios

Net D:E	(0.2)	(0.2)	(0.2)
RoE (%)	5.7	12.3	16.2
RoCE (%)	5.8	11.8	15.9

Valuations

P/E (x)	105.2	44.4	29.2
EV/EBITDA (x)	46.7	25.6	18.3

Shareholding pattern (%)

As on	Dec-23	Sep-23
Promoter	51.0	51.1
DII	17.1	16.3
FII	5.7	9.2
Others	26.3	19.7

Note: FII includes depository receipts

Valuation and view

- We believe the ongoing slowdown in the US operation will have a short-term impact on Avalon's revenue and profitability. However, the long-term trajectory remains strong backed by: 1) an increase in the mix of box build through new orders and increasing the wallet share from existing customers; and 2) order inflows from the high-growth/high-margin industries, such as Clean Energy and Aerospace.
- We estimate Avalon to deliver a CAGR of 16%/15%/29% in revenue/EBITDA/Adj. PAT over FY23-26 on the back of strong order inflows.
- Factoring in the weak 3QFY24 performance and a slowdown in the US business that led to an operating deleverage, we reduce our EPS estimates for FY24/FY25/FY26 by 44%/25%/19%. **Reiterate BUY with a TP of INR610 (premised on 35x FY26E EPS).**

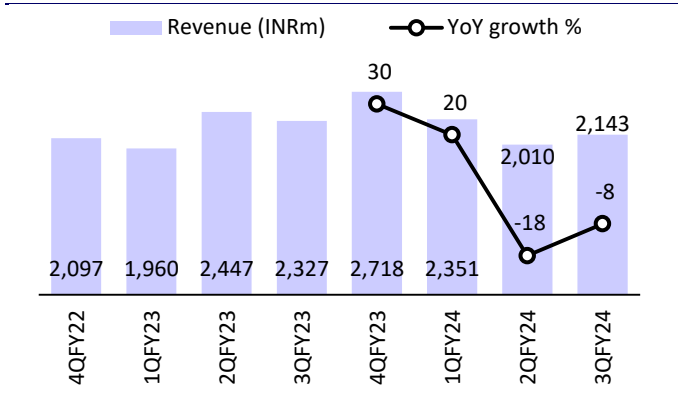
Consolidated - Quarterly Earnings Model

(INR m)

Y/E March	FY23				FY24				FY23	FY24E	FY24E	Var %
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		3QE		
Gross Sales	1,960	2,447	2,327	2,718	2,351	2,010	2,143	2,310	9,447	8,814	2,676	-20
YoY Change (%)	NA	NA	NA	NA	19.9	-17.9	-7.9	-15.0	350.4	-6.7	15.0	
Total Expenditure	1,765	2,161	2,125	2,307	2,189	1,884	1,977	2,082	8,319	8,132	2,420	
EBITDA	195	286	202	411	162	126	165	228	1,128	682	256	-35
Margins (%)	10.0	11.7	8.7	15.1	6.9	6.3	7.7	9.9	11.9	7.7	9.6	
Depreciation	46	49	50	52	53	55	60	73	197	241	62	
Interest	71	100	86	95	56	32	36	40	348	165	37	
Other Income	66	64	12	38	51	47	22	30	144	150	40	
PBT before EO expense	145	201	78	302	105	86	91	145	727	426	197	
Extra-Ord expense	0	0	0	0	0	0	0	0	0	0	0	
PBT	145	201	78	302	105	86	91	145	727	426	197	
Tax	52	53	21	75	34	13	25	39	202	111	53	
Rate (%)	35.8	26.6	26.7	24.7	32.4	15.2	27.5	27.0	27.8	26.0	27.0	
Minority Interest & Profit/Loss of Asso. Cos.	0	0	0	0	0	0	0	0	0	0	0	
Reported PAT	93	148	57	227	71	73	66	106	525	315	144	
Adj PAT	93	148	57	227	71	73	66	106	525	315	144	-54
YoY Change (%)	NA	NA	NA	NA	-23.9	-50.7	14.7	-53.3	NA	-40.0	150.8	
Margins (%)	4.7	6.0	2.5	8.4	3.0	3.6	3.1	4.6	5.6	3.6	5.4	

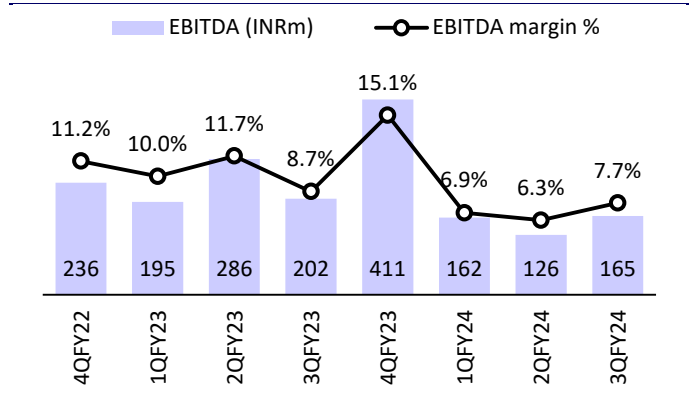
Key exhibits

Exhibit 1: Consolidated revenue trend



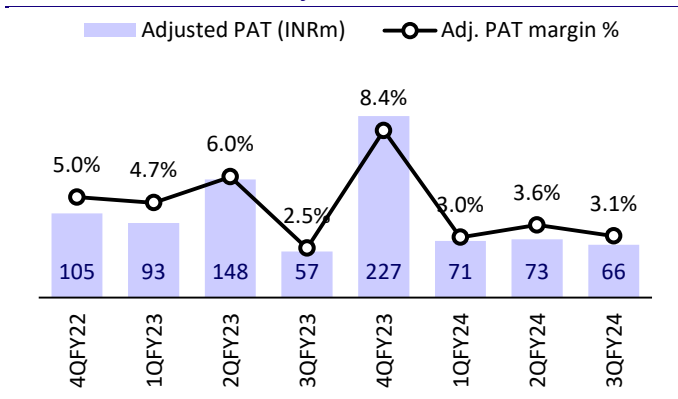
Source: Company, MOFSL

Exhibit 2: Consolidated EBITDA trend



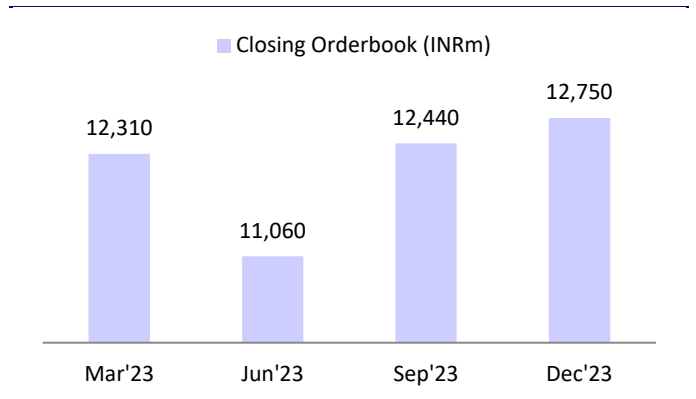
Source: Company, MOFSL

Exhibit 3: Consolidated Adj. PAT trend



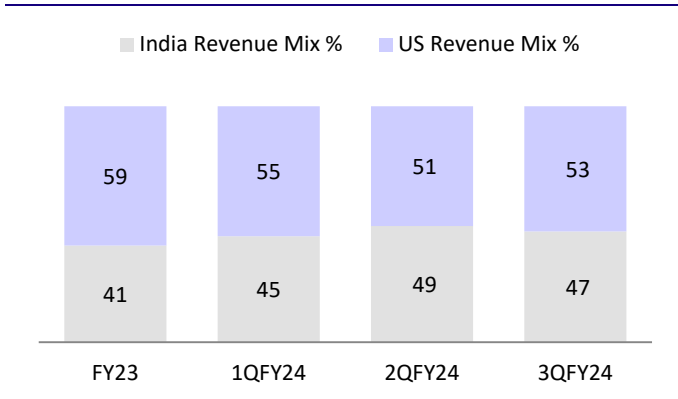
Source: Company, MOFSL

Exhibit 4: Order book trend



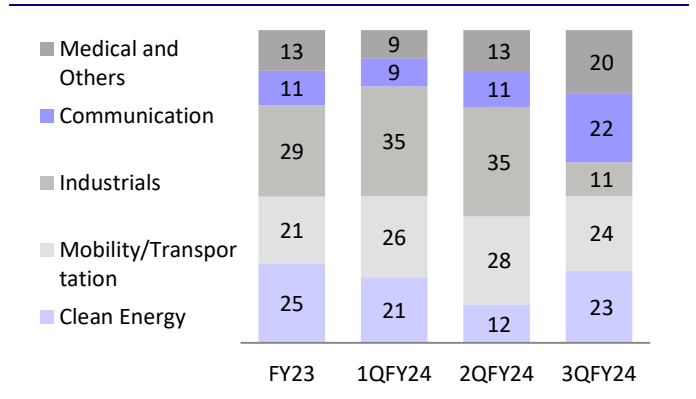
Source: Company, MOFSL

Exhibit 5: Region mix



Source: Company, MOFSL

Exhibit 6: End-user industry mix



Source: Company, MOFSL



Highlights from the management commentary

Indian business

- Indian operations witnessed ~12% YoY revenue growth in 9MFY24.
- The Indian manufacturing segment (~77% of total manufacturing) continues to remain profitable, with EBITDA margin of ~12.8% and PAT margin of 7.8% in 9MFY24.
- However, losses in the US operations are temporarily outstripping the healthy performance of Indian operations, and are affecting the consolidated results.
- Growth within the domestic business of Avalon is lesser as compared to that of the industry as traditionally, Avalon has an export-oriented business (with ~70% of exports). It has started focusing on domestic business over the last few years.
- Management believes that the growth story in India has just begun, and it will accelerate going ahead.
- The company expects a strong traction from railways (Signaling system, Kavach, Vande Bharat), Industrial, and Energy industry in the domestic market. It is also witnessing a traction within the EV space.

US business

- The US operations continue to witness significant challenges and accordingly recorded a loss of INR200m in 9MFY24
- The company is actively addressing the challenges. Accordingly, it is focusing on shifting production from the US to India and rationalizing cost within the US business. However, Avalon is already witnessing tractions from some of the customers in the US.
- Going ahead, the US market is expected to witness a recovery in demand in 1HFY25m, which will be further accelerated in 2HFY25.

Guidance

- For FY24, the company is expecting a revenue decline of ~8-10% YoY due to challenges in the US business. Avalon expects subdued EBITDA margin of 7-8% for FY24.
- However, the gross margin of ~46% in 9MFY24, reflects a high profitability within the business model. The company will report an improvement in margins with the increase in revenue
- Going ahead, the company expects to grow its revenue by ~20-25% p.a.

Capacity expansion

- Management is planning to expand its existing domestic facilities for addressing the increasing domestic business
- One new manufacturing plant at Chennai is expected to be commissioned by 1QFY25.
- The company expects a capex of ~INR350-400m every year

Orders

- Order book as on Dec'23 stood at ~INR12.75b. The orders are executable over next 12-14 months. However, it includes long duration orders of ~INR8.4b, which will be executed over the next couple of years.

- Major wins in the US and India across sectors such as Power, Industrial, Clean energy, Automotive and Rail
- The order book of the company is equally split. It is witnessing increasing orders from the domestic business.

Railway Segment

- Signaling system, Kavach and Vande Bharat will be the key growth drivers within the railway segment
- The Railways has approved three domestic and two international players for deployment of Kavach.
- Avalon is actively working with one of the international players within the space. However, it will take some time for orders to flow in.

Others

- The company is focusing on its Indian business with an aim to increase the domestic share of revenue to ~50%. The share of domestic revenue has increased to ~47% in FY24 from ~41% in FY23.
- Avalon is now a strategic manufacturing partner for C-DAC, playing a pivotal role in advancing India's capabilities in High-Performance Computing through, the 'RUDRA' program.
- The company has successfully delivered the first wiper blade assembly sample, marking a key milestone in the Aerospace segment.
- The company has not taken any decision regarding the semiconductor business as of now.
- Avalon has fully utilized the IPO funds
- Working capital days stood at ~155 in 3QFY24. Going ahead, the company expects to reduce working capital by ~10-15 days.

Valuation and View

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- We estimate Avalon to deliver a CAGR of 16%/15%/29% in revenue/EBITDA/Adj. PAT over FY23-26 on the back of strong order inflows.
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Exhibit 7: Changes to our estimates

Earnings change (INR m)	Old			New			Change		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	10,298	13,079	16,349	8,814	11,282	14,666	-14%	-14%	-10%
EBITDA	987	1,556	2,076	682	1,241	1,731	-31%	-20%	-17%
Adj. PAT	561	991	1,401	315	746	1,135	-44%	-25%	-19%

Financials and valuations

Consolidated - Income Statement							(INRm)
Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	6,419	6,905	8,407	9,447	8,814	11,282	14,666
Change (%)	NA	7.6	21.8	12.4	-6.7	28.0	30.0
RM Cost	4,128	4,574	5,552	6,067	5,647	7,322	9,460
Employees Cost	1,162	1,192	1,314	1,605	1,829	1,929	2,493
Other Expenses	484	478	566	647	656	790	983
Total Expenditure	5,774	6,243	7,432	8,319	8,132	10,041	12,936
% of Sales	90.0	90.4	88.4	88.1	92.3	89.0	88.2
EBITDA	645	662	975	1,128	682	1,241	1,731
Margin (%)	10.0	9.6	11.6	11.9	7.7	11.0	11.8
Depreciation	155	158	172	197	241	280	326
EBIT	490	504	803	931	441	961	1,404
Int. and Finance Charges	450	270	248	348	165	78	29
Other Income	113	54	309	144	150	147	191
PBT bef. EO Exp.	153	288	864	727	426	1,029	1,566
EO Items	0	0	0	0	0	0	0
PBT after EO Exp.	153	288	864	727	426	1,029	1,566
Total Tax	30	58	183	202	111	283	431
Tax Rate (%)	19.4	19.9	21.1	27.8	26.0	27.5	27.5
Minority Interest	8	16	50	0	0	0	0
Reported PAT	115	215	632	525	315	746	1,135
Adjusted PAT	115	215	632	525	315	746	1,135
Change (%)	NA	86.1	193.9	-16.9	-40.0	136.7	52.2
Margin (%)	1.8	3.1	7.5	5.6	3.6	6.6	7.7

Consolidated - Balance Sheet							(INRm)
Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	15	16	16	116	131	131	131
Preference Capital	356	388	388	0	0	0	0
Total Reserves	450	584	856	5,254	5,570	6,316	7,451
Net Worth	822	988	1,260	5,370	5,700	6,446	7,582
Minority Interest	-431	-317	0	0	0	0	0
Total Loans	2,388	2,775	2,789	3,063	963	463	63
Deferred Tax Liabilities	-263	0	0	0	0	0	0
Capital Employed	2,515	3,445	4,049	8,433	6,663	6,909	7,644
Gross Block	1,126	1,335	1,512	1,861	2,159	2,548	2,961
Less: Accum. Deprn.	139	295	390	586	827	1,107	1,433
Net Fixed Assets	987	1,041	1,123	1,275	1,332	1,441	1,528
Goodwill on Consolidation	0	0	0	0	0	0	0
Capital WIP	27	0	20	153	206	266	253
Total Investments	24	0	0	0	0	0	0
Current Investments	0	0	0	0	0	0	0
Curr. Assets, Loans&Adv.	3,197	4,084	4,738	10,375	7,026	7,541	8,746
Inventory	1,553	1,458	2,330	3,179	2,243	2,608	3,240
Account Receivables	1,138	1,819	1,774	2,062	1,811	2,318	3,014
Cash and Bank Balance	266	335	101	4,219	2,267	1,825	1,613
Loans and Advances	241	472	532	915	705	790	880
Curr. Liability & Prov.	1,719	1,680	1,831	3,370	1,901	2,339	2,882
Account Payables	1,369	1,289	1,242	1,418	1,160	1,504	1,944
Other Current Liabilities	216	253	449	1,823	617	677	733
Provisions	134	138	141	130	123	158	205
Net Current Assets	1,478	2,404	2,906	7,005	5,125	5,202	5,863
Misc Expenditure	0	0	0	0	0	0	0
Appl. of Funds	2,516	3,445	4,049	8,433	6,663	6,909	7,644

Financials and valuations

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)							
EPS	2.0	3.7	10.9	9.1	4.8	11.4	17.4
Cash EPS	4.7	6.4	13.9	12.5	8.5	15.7	22.4
BV/Share	14.2	17.0	21.7	92.7	87.3	98.7	116.1
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)							
P/E	254.8	136.9	46.6	56.0	105.2	44.4	29.2
Cash P/E	108.7	79.0	36.6	40.8	59.6	32.3	22.7
P/BV	35.8	29.8	23.4	5.5	5.8	5.1	4.4
EV/Sales	4.8	4.6	3.8	3.0	3.6	2.8	2.2
EV/EBITDA	48.3	47.7	32.9	25.1	46.7	25.6	18.3
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	8.4	-2.4	-0.4	-7.0	2.3	-0.1	0.4
Return Ratios (%)							
RoE	14.1	23.8	56.2	15.8	5.7	12.3	16.2
RoCE	15.1	12.8	22.5	12.4	5.8	11.8	15.9
RoIC	21.4	17.7	20.2	17.7	7.9	15.5	19.2
Working Capital Ratios							
Fixed Asset Turnover (x)	5.7	5.6	5.9	5.6	4.4	4.8	5.3
Asset Turnover (x)	1.5	1.3	1.4	0.8	1.0	1.2	1.4
Inventory (Days)	98	120	125	166	145	130	125
Debtor (Days)	65	78	78	74	75	75	75
Creditor (Days)	87	106	83	80	75	75	75
Leverage Ratio (x)							
Current Ratio	1.9	2.4	2.6	3.1	3.7	3.2	3.0
Interest Cover Ratio	1.1	1.9	3.2	2.7	2.7	12.3	48.6
Net Debt/Equity	2.6	2.5	2.1	-0.2	-0.2	-0.2	-0.2

Consolidated - Cash Flow Statement

(INRm)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	153	288	856	727	426	1,029	1,566
Depreciation	155	158	180	197	241	280	326
Interest & Finance Charges	434	222	209	244	15	-68	-162
Direct Taxes Paid	-47	-35	-125	-189	-111	-283	-431
(Inc)/Dec in WC	-121	-561	-805	-1,125	-73	-518	-874
CF from Operations	574	72	315	-147	498	440	425
Others	83	-17	-158	13	0	0	0
CF from Operating incl EO	657	55	157	-133	498	440	425
(Inc)/Dec in FA	-170	-192	-177	-273	-350	-450	-400
Free Cash Flow	487	-137	-21	-406	148	-10	25
(Pur)/Sale of Investments	-24	29	0	0	0	0	0
Others	2	-104	-6	2	150	147	191
CF from Investments	-192	-267	-184	-271	-200	-303	-209
Issue of Shares	0	73	0	798	15	0	0
Inc/(Dec) in Debt	-296	461	158	128	-2,100	-500	-400
Interest Paid	-426	-217	-189	-283	-165	-78	-29
Dividend Paid	-4	-37	-38	-37	0	0	0
Others	302	22	-138	3,915	0	0	0
CF from Fin. Activity	-424	301	-207	4,522	-2,250	-578	-429
Inc/Dec of Cash	42	89	-234	4,118	-1,952	-441	-213
Opening Balance	204	246	335	101	4,219	2,267	1,825
Other cash & cash equivalent	20	0	0	0	0	0	0
Closing Balance	266	335	101	4,219	2,267	1,825	1,613

Investment in securities market are subject to market risks. Read all the related documents carefully before investing

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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